

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Morrow and McClintock Analyst: Anne Mazur Bill Number: SCA 23
Related Bills: See Legislative History Telephone: 845-5404 Introduced Date: February 8, 2006
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Appropriations Limit/FTB and Controller Facilitate Timely Issuance of Tax Rebates

SUMMARY

This measure would require revenues in excess of the amount appropriated by the Legislature to be rebated in the following fiscal year to certain specified taxpayers.

This analysis will not address the measure's changes to other provisions of the California Constitution regarding appropriations limits, local mandates, and school funding as they do not impact the department or state income tax revenue.

PURPOSE OF THE MEASURE

It appears the purpose of this measure is to limit state spending and borrowing and return all excess revenue to taxpayers.

EFFECTIVE/OPERATIVE DATE

This measure would become effective the day following approval by the voters in the general election following approval of the measure by the Legislature. If approved in the November, 2006, general election, the measure would apply to fiscal years beginning on and after the effective date.

POSITION

Pending.

ANALYSIS**FEDERAL/STATE LAW**

Currently, specific provisions of Article XIIB of the California Constitution:

- Prohibit a governmental entity's annual appropriation from exceeding its annual limit, which is adjusted annually for the cost of living and population changes.
- Provide that:
 - o 50% of the revenues received by the state in a fiscal year and the next fiscal year that are in excess of the amount that may be appropriated by the state for the same fiscal years, are transferred to the State School Fund.
 - o The remaining 50% of the excess revenues must be returned by the state by revising tax rates or fee schedules within the next two subsequent fiscal years.

Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	_____ X PENDING

Department Director

Date

Selvi Stanislaus

3/20/06

For federal purposes, refunded state income taxes previously claimed as a deduction must be reported as income on the federal return for the taxable year in which refunded.

THIS MEASURE

This measure would amend, repeal, and replace sections of Article XIII B of the California Constitution. This measure would provide that all revenues collected in a fiscal year that exceed the amount that may be appropriated by the state for that fiscal year must be rebated after the end of that fiscal year to California taxpayers on a pro rata basis to persons, corporations, or other entities that paid taxes on, or measured by, income, for taxable years beginning during the prior calendar year. The Franchise Tax Board (FTB) and the Controller would jointly administer any actions necessary to timely issue the rebates. The measure specifies that the provision with respect to issuing rebates would be self-executing, but statutes may be enacted (i.e., enabling legislation) to facilitate its operation so long as those statutes are not in conflict with the constitutional provision.

IMPLEMENTATION CONSIDERATIONS

In its current version, the measure specifies that FTB and the Controller would jointly be responsible for administration of the rebate function. Unless specified in this measure, the following items, and any later identified concerns, would need to be addressed in future enabling legislation prior to the issuance of any rebates:

- Identification of the time frames for measuring existence and amount of excess revenue.
- Authority and methodology for determining the pro rata basis upon which the rebates would be issued. It appears from the measure that rebates would be issued on the basis of franchise or income taxes paid for the taxable year beginning in the calendar year prior to the fiscal year for which the rebates would be required to be issued. Department staff suggests the measure be revised to clarify the pro rata basis upon which the rebates would be determined and issued.
- Time frame for issuance of the rebates. To calculate rebates proportionate to the franchise or income tax paid, FTB would need to process all tax returns for the taxable year prior to calculating the rebate amount to ensure all eligible taxpayers are included. As such, department staff assumes the measure's reference to "prior calendar year" means the calendar year that ends prior to the beginning of the current fiscal year.
- Provisions of the Internal Revenue Code require reporting of state or local personal income tax refunds to the IRS. The rebate would be required to be reported to the IRS and may be subject to federal income taxes. The department would have to make computer system changes to account for and track rebates for reporting purposes since the reporting volume would increase to include all individual taxpayers that paid tax.
- Depending on the factors to be used in determining the proportionate rebate amount, certain circumstances could result in rebate revisions. These factors include the receipt of late filed returns, amended returns, audit adjustments resulting in revisions to franchise or income tax paid, or processing errors.

- Currently, FTB, IRS, and other state agencies participate in an offset process where refunds are offset to satisfy an outstanding liability owed by the taxpayer to another government entity. Without clarification, this could be construed as either a payment of excess state revenues or a refund of taxes paid. As such, clarification would be needed on whether these payments would be subject to the agency-offset process or could be offset against a taxpayer's unpaid franchise or income tax liabilities for other years.

LEGISLATIVE HISTORY

SCA 2 (McClintock, et al., 2005/2006) and SCAX 2 (McClintock, 2005/2006) would have required revenues in excess of the amount appropriated by the Legislature to be rebated within 18 months to personal income tax return filers in proportion to social security taxes paid. Both measures died in Senate policy committees.

SCA 3 (McClintock, et al., 2003/2004) would have required the FTB and the State Controller to issue rebates to taxpayers, on a pro rata basis, of a portion of the revenues received by the state in excess of the amount appropriated by the state during the fiscal year. This measure failed passage with the Senate Committee on Revenue and Taxation.

SCA 16 (McClintock, 2003/2004) would have required all excess state revenues to be returned via revision of the tax rates or fee schedules. This measure failed passage with the Senate Committee on Education.

ACA 6 (Campbell, 2003/2004) and SCA 16 (McClintock, et al., 2001/2002) would have required FTB and the State Controller to issue rebates of excess revenues. These measures failed to pass out of committee.

AB 2609 (Stats. 1987, Ch. 915) and SB 47 (Stats. 1987, Ch. 908) authorized a tax rebate of excess funds for the 1986 taxable year. Qualified taxpayers were allowed a tax rebate of 15% of the tax imposed by the income tax law, as defined, with specified minimum dollar limits and maximum dollar limits. The rebate was calculated and administered by FTB. The Controller was required to send rebate checks to taxpayers by January 15, 1988.

OTHER STATES' INFORMATION

A review of the state laws and constitutions of *Florida*, *Massachusetts*, *Michigan*, and *Minnesota* revealed the following:

- *Florida*, which has no personal income tax, requires excess revenues to first be transferred to a budget stabilization fund up to a specified maximum balance, and thereafter be refunded to taxpayers.
- *Minnesota* requires excess revenues to be refunded to the taxpayers in the form of sales tax rebates.
- *Massachusetts* allows a credit, called the "excess revenue credit," toward taxpayers' personal income tax liabilities.

- *Michigan* requires revenues that exceed the established limit by 1% or more to be refunded on a pro rata basis that is based on the liability reported on the Michigan income tax and single business tax returns. Revenues that exceed the limit by less than 1% may be transferred to the budget stabilization fund.

A review of the *New York* and *Illinois* state laws and constitutions did not produce any information regarding a procedure for rebating or retaining excess revenues. The laws of these states were reviewed because of their similarities to California income tax laws.

FISCAL IMPACT

Depending on the level of responsibility given to the department, costs could be significant. At a minimum, the department would need to implement a system to calculate, issue, and track the rebates proposed in this measure. In addition, the department could have to reissue rebates returned as undeliverable or deposited into escheat, comply with additional revenue reporting requirements for rebates, and report on rebates within the offset program. It is likely that the department would receive additional phone calls and visits to field offices from taxpayers inquiring about the random selection of taxpayers receiving rebates.

ECONOMIC IMPACT

This measure would not impact personal income tax or corporate tax revenues.

LEGISLATIVE STAFF CONTACT

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